Bennett Jones LLP
4500 Bankers Hall East
855 2nd Street SW
Calgary Alberta
Canada T2P 4K7
Tel 403.298.3100
Fax 403.265.7219

N. P. Fader
Direct Line: 403.298.3474
e-mail: fadern@bennettjones.ca

November 21, 2002

Mr. Peter Brady
Chairman of the Continuous Disclosure Harmonization Committee
British Columbia Securities Commission
P.O. Box 10142
Pacific Centre
701 West Georgia Street
Vancouver, British Columbia
V7Y 1L2

Ms. Denise Brosseau
Secretary
Commission des Valeurs Mobilières du Québec
Stock Exchange Tower
800 Victoria Square
P.O. Box 246
22nd Floor
Montreal, Quebec
H4Z 1G3

Dear Sirs:

Re: Proposed National Instrument 51-102 (Continuous Disclosure Obligations), Form 51-102F1, Form 51-102F2, Form 51-102F3, Form 51-102F4, Form 51-102F5, Form 51-102-F6 and Companion Policy 51-102CP (Continuous Disclosure Obligations)

We take this opportunity to enclose our comment letter respecting proposed National Instrument 51-102 (Continuous Disclosure Obligations), the related forms and the Companion Policy. While we recognize that the cut-off period for comments expired in September 2002, we understand that you are still working your way through the various comment letters received and assessing appropriate modifications to the proposed Instrument. Having regard to our understanding that your consideration of the issues remains a "work in progress", we are hopeful that you will accept our comment letter, late as it is, and that the same will be of some assistance to you in your deliberations.

Thank you for your attention to this matter. If you have any questions relating to the foregoing, please do not hesitate to contact the undersigned directly at your convenience.

Yours truly,

BENNETT JONES LLP

"N. P. Fader"

N. P. Fader

NPF/jg
Enc.

B E N N E T T   J O N E S

Bennett Jones LLP
4500 Bankers Hall East
855 2nd Street SW
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Canada T2P 4K7
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Fax 403.265.7219

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e-mail: fadern@bennettjones.ca

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Alberta Securities Commission
British Columbia Securities Commission
Manitoba Securities Commission
Securities Administration Branch, New Brunswick
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Nova Scotia Securities Commission
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut
Ontario Securities Commission
Office of The Attorney General, Prince Edward Island
Commission des Valeurs Mobilières du Québec
Saskatchewan Securities Commission
Registrar of Securities, Government of Yukon

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Montreal, Quebec
H4Z 1G3

Dear Sirs:

Re: Proposed National Instrument 51-102 (Continuous Disclosure Obligations) (the "Rule"), Form 51-102F1, Form 51-102F2, Form 51-102F3, Form 51-102F4, Form 51-102F5, Form 51-102-F6 (collectively the "Forms") and Companion Policy 51-102CP (Continuous Disclosure Obligations) (the "Policy")

Reference is made to the Notice and Request For Comment, dated June 21, 2002, issued by the Canadian Securities Administrators with respect to the Rule, the Forms and the Policy (collectively, the "Release"). We appreciate the invitation to provide comments with respect to the Release and wish to outline our thoughts concerning selected elements of the Rule and Form 51-102F4 in particular.

By way of background, Bennett Jones LLP is a full service business law firm with offices in Calgary, Edmonton and Toronto. Our practice principally involves the provision of legal advice to Canadian businesses, both large and small. In that regard, we have had and continue to have occasion to advise businesses with respect to their continuous disclosure obligations under applicable corporate and securities legislation, principally in the provinces of Alberta and Ontario.

Please note that certain members of our firm attended a presentation by staff of the TSX Venture Exchange in August 2002, respecting the impact of the Rule, the Forms and the Policy on issuers whose securities are listed and posted for trading on the Exchange. In addition, we have been provided with and have had an opportunity to review the letter, dated August 29, 2002, forwarded to you by the TSX Venture Exchange, wherein the Exchange provided you with comments respecting the Release (the "TSXV Letter").

In this letter, we do not propose to provide comprehensive comments with respect to all elements of the Release. In large measure, our comments reflect our review of the TSXV Letter and provide advice as to whether we agree or disagree with the views of the Exchange. However, we do propose to spend additional time addressing the issue of the proposed business acquisition report and, in particular, the utility of the historical financial statement requirement associated therewith, having regard to the factors that drive acquisition transactions. From a "big picture" perspective, we believe that the requirement to create audited historical financial statements, where the same do not otherwise exist, is an unduly costly exercise that is generally not warranted in light of the benefits that emerge from that exercise.

In the Notice that accompanied the publication of the Release, the Canadian Securities Administrators observed (at page 2) that the business acquisition report is modeled on the significant acquisition requirements for prospectuses. On February 15, 2000, we provided comments to the Ontario Securities Commission ("OSC") with respect to its proposed long form prospectus rule. In that letter, which concentrated principally on the effect of the OSC's proposals on oil and gas issuers, we indicated that on a cost/benefit analysis the exercise of preparing historical financial statements, where the same simply did not exist, appeared to be unwarranted. In addition, we noted that the OSC ascribed an importance to historical financial statements that did not appear to be perceived by purchasers of assets and, in cases where acquisitions of properties were financed, by the underwriters/agents involved. We also noted that the OSC's position appeared to be unduly weighted in favor of a technical accounting approach. In short, it was taken as an article of faith by the OSC that historical financial statements provide significant value to the analysis of business combination transactions, either to form a view of the appropriate price for the relevant assets or assess the future prospects for those assets.

From our perspective, it is not at all clear that historical financial statements of a target provide the value implicitly assumed in the Ontario long form prospectus rules and in the proposed business acquisition report. In our view, the fixation with historical financial statements embedded in those prospectus rules and the proposed business acquisition report is not a significant factor that drives business combination transactions. Often, the manner in which the acquiror proposes to utilize acquired assets is so divergent from the target, that historical financial statements of the target will be an inadequate road map to the future performance of those assets.

We propose to return to this issue in more detail below.

For convenience of reference, we have structured our letter in the same manner as the TSXV Letter.

1. Overview of the Continuous Disclosure Philosophy.

In its letter, the TSX Venture Exchange indicated that small businesses are generally under intense cost pressure and the proposals do not sufficiently address the fundamental differences between small businesses and more senior issuers. We agree with both of those observations. Small business issuers obviously lack the financial resources of their more senior counterparts. In particular, small business issuers generally lack the resources to internalize certain continuous disclosure obligations and must out-source the same to third party service providers. Representatives of small business issuers continuously provide us with feedback that the regime has become far too costly and many start-up issuers now view the prospect of going public as a last resort.

2. Business Acquisition Report

In its letter, the TSX Venture Exchange focused upon the impact of the business acquisition report requirement on small issuers and noted that, in most cases, the benefits of the report will not justify the cost to shareholders. While we agree with the observations of the Exchange in that regard, we believe that concerns respecting the business acquisition report are applicable to a universe of issuers larger than just small businesses.

At the outset of our comments, we should note that the utility of historical financial information as an indication of the appropriate price for assets and the correlation between the historical financial statements of an acquired business and the future performance of the affected assets, are "business school" types of inquiries, that we, as lawyers, are not fully equipped to analyze. Nonetheless, M&A transactions tend to attract attention in the business press and business sources are replete with commentary concerning M&A deals and the reasons for the various successes and failures. What is striking about the analysis of various high profile M&A transactions, for present purposes, is the fact that the reasons for success or failure would not have been quantifiable with reference to the historical financial statements available at the time the deals were struck or approved by securityholders. While financial statements (if they exist) provide a useful tool in the due diligence exercise undertaken by an acquiring entity, they do not appear to represent a definitive source of pricing information or to have much in the way of predictive value for determining the success of an acquisition transaction or the future performance of a combined entity.

On the topic of the price paid for assets in M&A deals, Bruce Wasserstein (Chairman and Chief Executive Officer of Wasserstein Perella & Co.) has noted:

> Buying companies is like participating in an art auction. The losers think the winner overpaid and, if there are ten potential buyers, the bidder in fifth place seems the most reasonable. But of course, that bidder hasn't bought anything. Meanwhile, the losers often spend time denigrating the wisdom of the buyer.
>
> *Truth, here, is not only elusive, but intensely subjective. It may well be that the price paid by the buyer makes perfect sense for it and none at all for the fifth-place finisher due to potential synergies or other strategic considerations that the winner will enjoy.* For example, Shell Oil could pay more than its competitors for the Belridge Oil properties because Shell had superior recovery technology. [1] [Emphasis added.]

For present purposes, Mr. Wasserstein's reference to the subjectivity of the pricing decision is important. In many cases, it will not be the historical financial statements of the target that drives either the price paid for assets or the economic performance of those assets in the hands of the acquiror. In the Shell Oil case referred to above (and in others), attributes of the purchaser (that were likely not quantifiable with reference to the purchaser's *own* financial statements) drove the determination of price. Historical financial statements, in isolation, did not provide a determinative view of the appropriate price of the asset. (In addition, it should be noted that historical financial statements are generally prepared using the historical cost method and, consequently, will not disclose an increase in the value of assets.) Of course, if information contained in historical financial statements did provide a definitive source of pricing information or a reliable road map to future performance, bidders for assets would not reach remarkably different conclusions with respect to the value of the target assets in their hands and auction processes would not produce significantly divergent bids from participants. The analysis of an asset would be easy and would produce substantially the same conclusions for all involved. In the real world of M&A transactions, of course, this does not happen for a variety of reasons.[2]

[1] B. Wasserstein, *Big Deal: 2000 and Beyond* (New York: Warner Books, 2000) at 583.
[2] The tax attributes of an acquiror, for example, are one factor that, although not evident in a target's financial statements, often influence the price the acquiror is prepared to pay for assets.

As Mr. Wasserstein has also noted, "[s]uccess in the merger business comes from spotting the underlying value".[3] That observation was made in connection with a review of the Kohlberg, Kravis Roberts & Co. ("KKR") acquisition of Duracell. That acquisition happened after a determination was made on behalf of Kraft Inc. to sell its Duracell business. A bidding war erupted among various parties, which ultimately resulted in a purchase price far in excess of Kraft Inc.'s original expectations. Ultimately, the acquisition turned out to be beneficial for KKR.

Mr. Wasserstein has noted that, based on available financial information, the $1.8 billion purchase price for Duracell was considered to be aggressive at the time the deal was agreed to:

> Some reports chalked it up as another case of LBO guys needing to spend the money they controlled. The price represented roughly 14 times Duracell's 1987 earnings before interest and taxes (EBIT) and 11 times EBITDA… *But the key to the valuation was KKR's vision of the future value in Duracell.*
>
> As it turned out, Duracell soared. Kidder and his team trimmed administrative costs, increased R&D spending, and grabbed market share from Eveready. Innovations like a disposable battery tester and strong international sales drove cash flow above the original projections, and Duracell was able to repay $224 million of senior debt ahead of schedule.
>
> …
>
> *As can only be seen in hindsight, the Duracell purchase price had been a bargain*.[4] [Emphasis added.]

In the KKR/Duracell case, the business acquisition transaction proved to be very beneficial to the acquiror. Of interest for present purposes is the fact that the success of the merger was driven by events and developments (i.e., reducing administrative costs, increasing the R&D effort and acquiring market share from a competitor) that could not have been quantified with reference to the target's historical financial statements. (This is a theme to which we will return during the course of review of the other examples set forth below.) In the KKR/Duracell example, a review of historical financial information would have suggested that the KKR purchase price was excessive.

Mr. Wasserstein has noted this point in another context: "[a] large part of success comes not only from the price at which an asset is bought, *but how it is employed in the future and how well the subsequent opportunities the deal provides or exploited"*.[5] [Emphasis added.] In short, things like a different marketing strategy may make a business combination transaction work or cause its failure. Of course, the utility of a future marketing strategy cannot be quantified with respect to the historical financial statements of a target. The Quaker Oats experience (both with Gatorade and Snapple)

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[3] *Supra* note 1 at 601.
[4] *Ibid*. at 602-603.
[5] *Ibid*. at 583-84.

provides an indication of the importance of a well executed marketing strategy. In an article that appeared in the January 2002 edition of *Harvard Business Review* John Deighton noted that:

> Even now, mere mention of Quaker Oats' acquisition of Snapple causes veteran deal makers to shudder…In 1993, Quaker paid $1.7 billion for the Snapple brand, outbidding Coca-Cola, among other interested parties. In 1997, Quaker sold Snapple to Triarc Beverages for $300 million, a price most observers found generous.[6]

Echoing that thought, Mr. Wasserstein has noted that the Snapple acquisition, "may go down as one of the worst deals of the 1990s …".[7] Could the historical financial statements of Snapple have allowed a reader to accurately predict this outcome? We doubt it. Professor Deighton's article reviews, in some detail, the reasons why the Snapple acquisition did not work for Quaker Oats. In short, the debacle was the result of a failed marketing strategy:

> Another element of Quaker's Snapple strategy came straight out of the Gatorade playbook. Just as it has done with Gatorade, Quaker introduced Snapple in larger, more profitable sizes: in 32-and-46-ounce bottles. But consumers simply didn't want them. The larger bottles were suitable for Gatorade because people tended to drink it during or after team practice or other exercise, when they were especially thirsty and needed to be rehydrated. But Snapple was a lunchtime beverage - people weren't looking for anything larger than a 16 ounce bottle they could polish off during one sitting.[8]

In this instance as well, we are at a loss as to understand how historical financial statements for Snapple would have permitted anyone to predict the future performance of the Snapple assets or to quantify the impact of the Quaker Oats' marketing failure.

The Snapple experience contrasts sharply with the performance of Gatorade under Quaker Oats' stewardship. The background to the Gatorade purchase is set out by Mr. Wasserstein as follows:

> In 1984, the company [Quaker Oats] purchased Stokley-Van Camp for $220 million. Some analysts called the price too generous, but by 1990 the deal would be hailed in a *Business Week* article as one of the "standout acquisitions" of the 1980s. Gatorade proved the hidden gem in the deal. Stokley had sold the sports beverage line mostly in the

[6] J. Deighton, "How Snapple Got It's Juice Back" (2002) 80:1 Harv. Bus. Rev. 47 at 47.
[7] *Supra* note 1 at 586.
[8] *Supra* note 6 at 49.

> Southeast and lacked a coherent marketing strategy. But, looking at the fundamentals, Quaker saw an opportunity.[9]

Mr. Wasserstein goes on to note, "[t]he acquisition paid off phenomenally well. Sales grew at a 30 percent annual rate through 1989 and in that year, Gatorade's operating profit of $125 million accounted for roughly one fifth of Quaker's total".[10]

In our view, this is another example of a circumstance in which historical financial statements would not have provided useful guidance with respect to the appropriate price to be paid for the asset or the outcome of the acquisition transaction. In contrast to its experience with Snapple, the Gatorade acquisition represented the triumph of a well formulated and executed marketing plan[11], the effect in which could not have been quantified in advance with reference to historical financial statements.

Earlier, we noted that the regulatory preoccupation with historical financial statements, in our experience, is often not mirrored in the M&A process itself. Directors in certain industries are certainly interested in historical returns on classes of assets, however, acquisition transactions are undertaken because the acquiring entity believes it can do a better job with the assets, i.e., the acquiror believes it will earn a return on the assets that is greater than was the case in the past. This should not come as a surprise – no one invests $1.00 simply to make $1.00. Accordingly, in M&A transactions, attention is quickly diverted from the past to the future, as boards endeavor to understand the synergistic benefits offered by a combination of separate businesses. How this focus on future synergies played itself out in connection with a recent, high profile M&A transaction is described in some detail by the Court of Chancery of the State of Delaware in its opinion relating to the Hewlitt Packard/Compaq litigation. In that transaction, management of Hewlitt Packard recognized that the effective integration of Compaq and Hewlitt Packard would be essential to ensure the success of a business combination between the two companies.

In its opinion, the Delaware Chancery Court provided insight into the process undertaken by Hewlitt Packard in respect of its massive integration effort. As noted in the Court's opinion:

> Throughout the process, integration planning focused on four main pillars: product roadmaps, go-to-market, financial accountability, and launch. From a logistical standpoint, integration initially was to be conducted by a "clean team," a select group of HP and Compaq employees who had access to sensitive, nonpublic information from both companies in a

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[9] *Supra* note 1 at 585.
[10] *Ibid.* at 586.
[11] Elements of the plan are described by Mr. Deighton as follows: "Quaker had an impressive record in beverage marketing, having developed Gatorade into a powerhouse national brand by skillfully executing a plan drawn straight from the marketing textbooks. After purchasing the sports drink from Stokley-Van Camp in 1983, Quaker introduced it into 26 foreign markets, added five new flavors (for a total of eight), and hired basketball great Michael Jordan as a spokesman. It used its leverage with supermarkets to win premium display space and squeezed costs out of the supply chain". *Supra* note 6 at 49.

> "clean room." The clean team, through its access to this information, was able to start immediately identifying and estimating specific cost synergies (such as those related to procurement), determining what products and services the new company would offer, and working on plans to market those products and services, among other things. As integration progressed, the clean team grew from several hundred employees to well over a thousand, and ultimately integration planning expanded to include "unclean" members of the company's business units.[12]

The Court's reference to "sensitive, nonpublic information" is significant for present purposes. In assessing the merits of the business combination and insuring effective integration, recourse was had to information beyond that presented in historical financial statements. A review of the balance of the Delaware Chancery Court's opinion supports the view that the benefits of the merger, as seen through the eyes of the management and directors of Hewlitt Packard, were based on forward looking assumptions. In establishing future expectations with respect to revenue and cost savings, for example, the integration teams made assumptions with respect to future procurement and product lines, among other things. That Compaq's historical financial statements would have had considerable utility in such an exercise is not apparent to us.

In theory, as well as practice, historical financial statements will not generally be a useful guide to the future performance of acquired assets or a reliable indicator of the appropriate price of such assets. In an article that appeared in the March 2001 edition of the *Harvard Business Review*, Joseph L. Bower (Professor of Business Administration, Harvard Business School) analyzed various merger and acquisition strategies and the strategic objectives sought by acquirors in each case.[13] Prof. Bower categorized the M&A strategies under five separate headings: (i) the Overcapacity M&A; (ii) the Geographic Roll-up M&A; (iii) the Product or Market Extension M&A; (iv) the M&A as R&D; and (v) the Industry Convergence M&A. An examination of the strategic objectives associated with each category of transaction confirms what we have already noted above – historical financial statements are of little utility in assessing the price paid for assets or the likelihood of success of an acquisition transaction.

Prof. Bower notes that, in the case of an Overcapacity M&A, "[t]he acquiring company (part of an industry with excess capacity) will eliminate capacity, gain market share, and create a more efficient operation."[14] The strategy of the acquiror is to close certain facilities, eliminate various managers and rationalize various administrative processes. As a result, "the acquiring company has greater market share, a more efficient operation, better managers, more clout and the industry as a whole has less excess capacity".[15]

In this case, the acquired assets may be radically transformed and even sold off to a significant extent, with the result that financial statements that viewed those assets as an economic

[12] *Walter B. Hewlett* v. *Hewlett Packard Co.*, Lexis 35 (Del.Ch. 2002) at 6.
[13] J.L. Bower, "Not All M&As are Alike – and That Matters" (2001) 79:3 Harv. Bus. Rev. 93.
[14] *Ibid.* at 94.
[15] *Ibid.* at 95.

whole will have little utility to a reader attempting to evaluate the impact of the acquisition transaction. The drivers of success or failure in such a transaction are to be found elsewhere. Indeed, one of the examples of an Overcapacity M&A identified by Prof. Bower was the business combination between Daimler-Benz and Chrysler Corporation. The merger of those organizations gave rise to a number of corporate culture issues, which have been discussed at length in the business press. In his article, Prof. Bower noted:

> [W]hen participants in a megamerger don't share values - as in the case of Daimler and Chrysler - serious problems can arise. As I've noted, these companies' working styles and assumptions were extremely different from the start. And their differences ran even broader and deeper than they first appeared to. Daimler was an engineering-centered company, Chrysler was more sales and marketing focused. Daimler executives had more perks, but Chrysler executives were paid much more.[16]

In the end, issues of corporate culture led to defections from the Chrysler camp:

> The sources of Chrysler's energy - the top leaders of Chrysler's manufacturing, engineering and public relations departments - left quickly as they learned that their fate was to subordinate themselves to the functional bureaucracies in Stuttgart. *The perfect fit that seemed so obvious in the abstract was foundering on very real, fundamental differences in the way the two groups of managers thought about themselves, their roles, and their companies.*[17] [Emphasis added.]

Here again, it is difficult for us to envision how historical financial statements would have provided any reliable guidance on the culture issue that so plagued Daimler-Chrysler following the merger of those automakers.

The second M&A scenario analyzed by Prof. Bower, the Geographic Roll-up M&A, involves the expansion of an otherwise successful organization geographically, while allowing the acquired operating units to retain local autonomy. Prof. Bower notes that:

> Geographic roll-ups - unlike excess-capacity acquisitions - are often a win-win proposition, and, consequently, they're easier to pull off. *Being acquired by a larger company can help a smaller company solve a broad range of problems. These include succession; access to capital, national marketing, and modern technology; and competitive threats from larger rivals. [Emphasis added.]*[18]

[16] *Ibid.* at 97.
[17] *Ibid.*
[18] *Ibid. at 98.*

…

One of the examples of a Geographic Roll-up M&A cited by Prof. Bower was the acquisition by Banc One of various local banks during the 1980s. The economic environment in which those transactions occurred are set out by Mr. Wasserstein in his chapter on Financial Services:

> In response to these external forces of technology, globalization, and regulatory change, several themes emerge. First, there is massive consolidation within sectors, particularly commercial banking and insurance. Regional banks have combined to create super-regionals; super-regionals are combining to create national banks; and banks in the same market are merging as well. Size brings with it the ability to invest in technology and go global.[19]

In the case of the various bank mergers that occurred in the United States throughout the 1980's, the wave of M&A activity was driven by regulatory changes and macro economic factors. Historical financial statements of the acquired local banks would, it appears, have had little utility in predicting the successful implementation of the Banc One strategy, for example. Combining with the larger entity allowed the local banks to access technology, which customers were demanding, but which required significant investments in R&D that they may not have been able to undertake on a stand alone basis. To use Prof. Bower's words, the Geographic Roll-ups undertaken by Banc One were deals that made "sense because of the *acquirer's processes*: they turn[ed] the target company into a far more efficient business".[20] [Emphasis added]. Of course, historical financial statements of the targets would provide no guidance in quantifying these efficiency gains.

The third type of M&A transaction analyzed by Prof. Bower, the Product or Market Extension M&A, involves the use of acquisitions to extend a product line or obtain international coverage. The previously discussed acquisition of Snapple by Quaker Oats is held out by Prof. Bower as an example of this type of acquisition transaction, although the transaction did not have a happy ending for Quaker Oats. He notes that "[w]hen Quaker Oats acquired Snapple, for instance, it found that its advertising distribution processes were wholly unsuited to the target company's product line".[21] As discussed above, the correlation between the historical financial statements of Snapple and the ultimate failure of the Quaker Oats/Snapple transaction is not apparent. A second example cited by Prof. Bower involved Marks & Spencer, which "found that its famed distribution systems couldn't cope with Canadian geography when it acquired Peoples Department Stores".[22] Here too, the acquisition transaction turned on factors not readily quantifiable from historical financial statements.

In addition, Prof. Bower notes, in his recommendations to those proposing to undertake Market Extension M&As, that "cultural differences and government regulation often interfere with

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[19] *Supra* note 1 at 293.
[20] *Supra* note 13 at 98.
[21] *Ibid.* at 99.
[22] *Ibid.*

the implementation of core processes".[23] In our view, recourse to historical financial statements will tell a potential acquiror (or investors) very little about prospective cultural integration difficulties and bureaucratic intervention.

The fourth category of M&A transaction involves the use of acquisitions as a substitute for research and development. An example cited by Prof. Bower is the acquisition of over 60 companies by Cisco, which represented the use of acquisitions "in lieu of in-house R&D to build a market position quickly."[24]

As was the case with the Hewlett Packard/Compaq merger discussed above, integration issues are key to these types of transactions. As Prof. Bower notes:

> One huge challenge acquirers must face is holding on to key people. *The expertise of these individuals is far more valuable than the technology they've developed. Generally, the acquisition won't succeed if they leave*. Yet in all likelihood, the acquisition itself made these people rich, so they can easily leave if they don't like the ways in which the company is changing.[25] [Emphasis added.]

Risking redundancy to state the obvious, historical financial statements are of no utility in assessing the likely retention level of key employees.

Under the fifth M&A scenario, the Industry Convergence M&A, an acquiror "bets that a new industry is emerging and tries to establish a position by culling resources from existing industries whose boundaries are eroding".[26] Prof. Bower notes that:

> The challenge to management is even bigger than the other categories. Success depends not only on how well you buy and integrate but also, and more importantly, on how smart your bet about industry boundaries is.
>
> AT&T's recent history shows just how hard it is to make these bets and win. When AT&T acquired computer manufacturer NCR, it did so because AT&T (and many others) thought that computers and telecommunications were convergent industries. The combination never succeeded.[27]

Here again, M&A transactions are driven by future expectations. In addition, the prevailing thought process views the acquired assets from a completely different paradigm. The value of the acquired assets to the purchasing entity and the success of the transaction will depend, in large

[23] *Ibid*. at 99.
[24] *Ibid*. at 95.
[25] *Ibid*. at 100.
[26] *Ibid*. at 95.
[27] *Ibid*. at 100-101.

measure, on whether anticipated industry developments materialize. Of course, historical financial statements of a target corporation will provide little guidance with respect to the macro factors that will determine success or failure.

Prof. Bower notes that:

> Successful convergent deals seem to follow a sequence of steps. First, the acquirer's accounting–and–control systems are installed at the target company. Next, the acquirer starts to rationalize the nonessential processes (but there seems to be no great rush). Finally, the portfolio is pruned of businesses that do not fit the acquirer's strategic objectives.[28]

In short, the post-transaction integration/rationalization process may radically transform the package of assets to the point that historical financial data respecting the performance of those assets will prove an inadequate road map in assessing future expectations.

In a number of cases, including industry convergence mergers, historical financial statements will have little utility owing to dramatic changes in the acquired asset package. To a degree, the Policy recognizes this reality in Section 6.10(3)(c). The Policy nonetheless indicates that relief from the financial statement requirement will generally not be granted for the year in which the change in operations occurred or for the most recently completed financial year if the change in operations occurred during the business' current financial year. Here again, it is obvious to us that there is no real cost benefit analysis that informs the requirement for historical financial statements. We would argue that in these types of cases, by definition, the costs will significantly exceed the benefits of the exercise. Nonetheless, the regulatory fixation with historical financial statements prevails in the Release.

The foregoing analysis has been confined to a number of significant M&A transactions, which have been widely discussed in the business press. We recognize that it is not exhaustive. However, in discussing the foregoing examples, it is our hope to raise an issue as to the utility of historical financial statements in formulating a view of the price paid for acquired assets or the future performance of those assets in the hands of an acquiror[29]. Where historical financial statements do not exist, considerable cost, expense and delays are required to create and audit the same (or to come up with something in the nature of carve-out statements). Despite the attempt in the Notice to justify the business acquisition report with reference to a cost/benefit analysis, it is clear to us that various securities commissions do not care that the preparation of historical financial statements requires significant cost and time. That historical financial statements are taken, as an article of faith, to have

[28] *Ibid.* at 101.

[29] The issue is more pronounced in the case of oil and gas issuers. We agree with the observations of the Exchange in the TSXV Letter (page 3) that the critical information for oil and gas issuers cannot be obtained through an examination of financial statements; rather the critical data relates to oil and gas properties and is derived from technical reports. In addition, in most cases the base data contained in those technical reports is re-engineered by an acquiring entity before it determines what it is prepared to pay for an asset.

significant predictive value and that arguments of cost and delay are largely irrelevant, is evident in Section 6.10(1) of the Policy, where the view is expressed that "relief from the financial statement requirements of Part 8 of the Instrument should be granted only in unusual circumstances *not related to cost or the time involved in preparing and auditing the financial statements*". [Emphasis added.] As noted above, we do not share the implied faith in the utility of historical financial statements that is evident in the proposed business acquisition report. Any genuine analysis of the cost/benefit issue must, we would argue, be informed by a rigorous analysis of the actual utility of historical financial statements in assessing the price of assets and predicting the outcome of merger and acquisition transactions. We would encourage the various securities commissions to undertake that analysis and to provide issuers with a detailed summary of the resulting conclusions.

On various occasions in the past when we have been called upon to consider appropriate disclosure for a prospectus, where the proceeds of the offering are to be used to acquire assets, we have concluded that the best disclosure is that which replicates for readers the thought process of the management team and board of directors that determined to undertake the transaction. Of course, concerns with respect to liability for descriptions of future expectations often restricted the scope of a discussion that might otherwise have been helpful to potential investors (by allowing them to see an acquisition transaction through the eyes of management and the board). Nonetheless, we think that issuers ought to be encouraged to replicate the thought process of the decision makers in disclosure documents. Conversely, undue emphasis on information (such as historical financial data) not considered important by the individuals who assessed and authorized an acquisition transaction, has the potential to be misleading. In various contexts, securities regulators have cautioned against mechanical disclosure and disclosure of non-material information, and have encouraged genuine efforts to tailor disclosure to specific circumstances. See for example, the instructions in paragraphs (d) and (e) in Part I of Form 51-102F2 respecting the content of MD&A and paragraph (c) of Part 1 of Form 51-102F4 itself. Avoidance of mechanical/programmed material was again encouraged in the November 5, 2002 press release of the Canadian Securities Administrators concerning executive compensation disclosure.[30]

We agree that the avoidance of mechanical, programmed disclosure and a focus on information that is truly material to an issuer generally results in a more insightful presentation that has greater utility to users of the information. The requirement for automatic disclosure of historical financial statements in M&A transactions, in our view, is mechanical in the extreme. No analysis is to be undertaken to assess the utility of the financial statements - rather the target financial statements are assumed by securities regulators to have substantial utility even in cases where the persons charged with responsibility for analyzing and approving a transaction may have come to a different conclusion. We consider such blind faith in historical financial statements to be misguided. If management and the board of directors of an acquiror did not place significant reliance on historical financial data in reaching the conclusion to undertake an acquisition transaction, the exercise of putting that data front and center as if the decision makers thought it had considerable

[30] Canadian Securities Administrators, CSA News, "Regulators to Require Companies To Improve Executive Compensation Disclosure" (5 November 2002).

probative value risks leaving users of a disclosure document with a directionally misleading impression.

In addition, in recent months, stories in the business press respecting the inadequacy of issuers' financial statements have been legion. Concerns of this nature crop up from time to time in due diligence on M&A transactions. On occasion, potential acquirors have raised significant questions with respect to the financial statements of a target. For example, an acquiror may discount the reported earnings of a target for due diligence purposes owing to what it perceives to be an inappropriate depreciation/depletion/amortization policy. Understandably, if there are perceived issues with respect to a target's financial statements, an issuer would properly be concerned about reproducing that financial data with the expectation that it be taken at face value. On the other hand, a candid discussion of perceived deficiencies could de-rail a transaction or give rise to legal proceedings. Surely, this is not a desirable outcome. Do the securities regulators really expect issuers to reproduce a target's financial statements and then spend time describing to readers of the business acquisition report why it considered earnings to be overstated or why those financial statements are otherwise unreliable in some material respect?

In short, there may be very valid concerns, other than simple lack of utility, that would lead an issuer to wish not to hold out a target's historical financial statements in a manner that suggests they be relied upon.

3. 120 DAYS FOR ANNUAL FINANCIAL STATEMENTS

In its letter, the TSX Venture Exchange raised questions with respect to the appropriateness of the accelerated financial statement filing obligations contained in the Rule. Among other things, the Exchange indicated that, apparently, the only support for the accelerated filing requirement is that other jurisdictions have had the requirement for some time. The Exchange goes on to note that the fact the requirement exists in other jurisdictions is insufficient to support the change vis-a-vis small businesses. We are in agreement with that observation. In the circumstances, a genuine cost/benefit analysis is required.

The TSX Venture Exchange also noted that certain factual premises, obtained in a random sampling of issuers, suggest that the accelerated filing obligations will visit hardship upon small businesses. In particular, the Exchange indicated that for many small businesses implementation of the accelerated filing obligations will result in real changes to reporting deadlines that will be greater than 20 days. We are in agreement with the observations of the Exchange in that regard and note that anecdotal information collected by us in conversations with various clients and other professional advisors supports the factual conclusions outlined in the TSXV Letter.

On a unrelated note, it appears to us that the accelerated filing requirements will result in an increased number of accruals being made in order to allow issuers to meet the new filing deadlines. While we expect that issuers will make estimates for accrual purposes on a reasonable and professional basis, it may be the case that increased reliance upon accruals will result in less accurate financial statements and frequent revisions after actual figures are obtained. However, we recognize that this is not our area of expertise and leave it to others to address this issue, if it is felt to be important.

4. REVERSE TAKE-OVERS – OTHER MATTERS

In its letter, the TSX Venture Exchange indicated that the rules governing reverse take-over accounting and continuous disclosure following a GAAP RTO are complex and that dealing with those rules is usually a high cost and low value exercise for shareholders. Our experience with these types of transactions leads us to agree with those observations.

5. IMPLICATIONS FOR EXCHANGE DISCRETION UNDER CAPITAL POOL COMPANY PROGRAM

In its letter, the TSX Venture Exchange raised concerns with respect to the impact of the Release on the exercise of its discretion in certain circumstances. We are of the view that any erosion of the Exchange's capacity to exercise discretion in the context of specific transactions is undesirable. It is no secret that the Capital Pool Program (in its current formulation) is broken. Most issuers and advisors that we have spoken to on this point attribute the current state of the program to excessive bureaucracy, which produces costs that are frankly bewildering to issuers. It was once the case that capital pool transactions could be undertaken relevantly efficiently following extensive discussions with the Alberta Stock Exchange concerning particulars of a proposed transaction and a case by case assessment of the amount of disclosure required to adequately inform shareholders. Those days are long gone. However, it is not evident to us (or others who we have spoken to on this matter), that this new environment represents an improvement. Accordingly, we support the suggestions of the TSX Venture Exchange that certain exemptions from the proposed disclosure requirements be made available in the context of Capital Pool Company qualifying transactions.

6. IMPLICATION FOR EXCHANGE DISCRETION FOR CHANGES OF BUSINESS IN REVERSE TAKE-OVERS

In its letter, the TSX Venture Exchange indicated that the same concerns that apply with respect to the efficient operation of the Capital Pool Company Program also apply to Exchange issuers proposing to effect changes of business and reverse take-overs. In this case as well, we share the concern with respect to the loss of Exchange discretion. By parity of reasoning, we support the suggestion of the TSX Venture Exchange with respect to an exemption for small business Exchange issuers that are proposing to effect a change of business or reverse take-over.

7. CONCLUSION

In general, we are in agreement with the comments offered to you by the TSX Venture Exchange, including the observation that the proposals contained in the Release are generally supportable. The Canadian Securities Administrators are to be commended for the effort to accumulate the various continuous disclosure rules in one place and to harmonize those requirements. However, we share the Exchange's concern that a number of the proposals set forth in the Release rely too heavily, without direct research, on the regulatory regime in the United States. That regulatory regime cannot claim any particular monopoly on the capacity to avoid market disasters or issuer meltdowns. One thing, however, is certain – the cost of complying with the United States regime is significant. We believe that insufficient work has been done to assess the expense side of the "costs/benefit" analysis that should inform this inquiry. To the extent it exists in the Release, the analysis seems to be confined to the thought that more disclosure, prepared on an expedited basis is better. Something more than the customary justification for additional regulation ought to be required in the circumstances.

If you have questions relating to the foregoing please do not hesitate to contact any of the following members of our securities group directly at your convenience:

C. Perry Spitznagel 298-3153
J. Douglas Foster 298-3213
Nicholas P. Fader 298-3474

Yours truly,

BENNETT JONES LLP

"N. P. Fader"

N. P. Fader

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